Chapter Two

The Budget Outlook

The Omnibus Budget Reconciliation Act of 1993, enacted in early August, has significantly improved the budget outlook for 1994 through 1998. The Congressional Budget Office estimates that under current policies the deficit will fall from $266 billion in 1993 to $190 billion in 1996. The 1998 deficit of $200 billion is nearly $160 billion lower than CBO projected in its winter 1993 baseline.[1]

The good news that estimated deficits are substantially lower than previously anticipated is tempered, however, by the fact that the underlying trend of growing deficits has not been reversed. The deficits in CBO's winter baseline decreased gradually through 1996, then began rising. Although CBO's revised deficits are lower in each year and grow more slowly after 1996 than the winter projections, the new projections do not provide any indication of permanently declining deficits in the foreseeable future. The expectation that government spending on health care will continue to grow at double-digit rates is largely responsible for the stubbornly high deficits.

The reconciliation act will provide important long-term benefits for the economy. CBO now projects that the deficit in 1998 will equal 2.5 percent of gross domestic product, down from the winter estimate of 4.6 percent. Debt held by the public will increase only slightly relative to the economy, rising to 55 percent of GDP by 1998 instead of the 62 percent projected last March. The federal government will draw substantially less from private credit markets over the next five years. As a result, more resources will be available for private investment, which will enhance productivity and economic growth, and borrowing from abroad can be reduced. Ultimately, the lower deficits will increase the nation's standard of living. But under the current CBO economic forecast, large deficits will extend into the next century unless additional steps are taken to control spending and increase revenues.

The preceding discussion assumes that the projected deficits will be realized. Extension through 1998 of pay-as-you-go constraints on new direct spending and revenue legislation and enforceable limits on discretionary spending will help ensure that the promised deficit reduction is not undone by future legislation. Nevertheless, there can be no guarantee that deficits will fall to around $200 billion. An economy that is weaker than anticipated or entitlement spending that grows more rapidly than expected could push the deficits up, just as they did after the 1990 reconciliation bill was enacted.

For the first time in nearly three years, CBO's deficit reestimates are driven more by legislation than by changes in the economic forecast or other assumptions that affect budgetary projections. CBO's economic forecast has changed relatively little since March, with correspondingly little effect on deficit esti-

1. The winter baseline estimates were released by CBO on March 3, 1993. They were published later that month in Congressional Budget Office, "An Analysis of the President's February Budgetary Proposals," CBO Paper (March 1993). The baseline assumed compliance with the discretionary spending limits in the Budget Enforcement Act through 1995; discretionary outlays were assumed to grow at the same pace as inflation after 1995.

mates. A slight near-term slowdown in projected real economic growth reduces estimated revenues somewhat in most years, and a small increase in inflation drives up the cost of benefit programs such as Social Security. These deficit effects are offset, however, by reductions in net interest spending resulting from lower interest rates. Technical reestimates--reestimates not attributable to legislation or changes in the economic forecast--are relatively small in each year of the projection period, especially if reestimates of deposit insurance spending are excluded.

CBO now estimates that the 1993 deficit will be $266 billion, $36 billion below the winter estimate. Legislation has pushed the 1993 deficit up slightly, but larger technical reestimates--primarily higher revenue collections and slower spending for deposit insurance, Medicare, and Medicaid--reduce the deficit estimate by nearly $39 billion.

This chapter presents CBO's outlook for the federal budget under the updated CBO economic forecast described in Chapter 1 and the policies adopted as of the end of August 1993. It summarizes the effect of enactment of the Omnibus Budget Reconciliation Act of 1993 and other changes that have occurred since CBO's winter baseline. The chapter concludes with budget estimates displayed in the framework of the national income and product accounts used by economists.

The Deficit Outlook

CBO estimates that the total deficit will decline from $290 billion in 1992 to $190 billion in 1996 before growing to $200 billion in 1998 (see Table 2-1). By 1998, the deficit will equal 2.5 percent of GDP, down from 4.9 percent of GDP in 1992. However, CBO's extrapolation of its budget projections through 2003 indicates that the total deficit rises relative to the size of the economy after 1998 (see Box 2-1). The total deficit is simply the difference between federal revenues and outlays. It provides the most comprehensive measure of the government's fiscal activities. The current estimates assume no further change in direct spending or tax policies and compliance with the discretionary spending limits enforced by the Balanced Budget and Emergency Deficit Control Act.

A better measure of fundamental budget trends may be obtained by excluding certain transitory or otherwise misleading budgetary amounts from the deficit calculation. For example, CBO has highlighted in recent years a measure of the deficit that excludes spending for deposit insurance and contributions received from allies in support of Operation Desert Storm.

Annual expenditures for deposit insurance not only are notoriously volatile--they will swing from $66 billion in 1991 to an estimated negative $26 billion in 1993--but they also are poor indicators of the economic impact of deposit insurance. The true cost of the government's guarantee of deposits was incurred, although not recorded in the budget, when deposits were poured into bad investments by savings and loan institutions (S&Ls) and banks that were headed for insolvency. Cash transactions by deposit insurance agencies today do not represent any change in those costs. Furthermore, federal borrowing to fund those transactions has little effect on government's net demands on credit markets because the money borrowed is immediately reinjected into the markets through payments to depositors or financial institutions. Desert Storm contributions are also excluded from this measure of the deficit because they, too, have little effect on demand in the economy. Although the annual deficit amounts are different when deposit insurance spending and Desert Storm contributions are excluded, the pattern of deficits is similar--they decline from 1993 through 1996 but rise gradually after that.

Another useful measure of the deficit is one that excludes cyclical economic effects on federal spending and revenues as well as the effects of deposit insurance spending and Desert Storm contributions. In a slow economy, federal revenues are depressed and spending for some programs (such as unemployment insurance) is pushed up. The standardized-employment deficit is a measure of the deficit that current policies would generate if the economy were performing up to its potential in all years. The cyclical effect falls from $81 billion in 1993 to just $18 billion in 1998 as the economy moves closer to its potential. The pattern of the standardized-employment deficit in the projection period is similar to that of the total deficit--deficits decline from the 1993 level but begin climbing again after mid-decade.

The final measure of the deficit that CBO reports is the on-budget deficit, which excludes the transactions of the Social Security trust funds (Old-Age and Survivors Insurance and Disability Insurance) and the Postal Service. The on-budget deficit has little utility from an economic perspective; although designated as off-budget, the trust fund and

Table 2-1.
The Deficit Outlook Under Current Policies (By fiscal year)

	Actual 1992	1993	1994	1995	1996	1997	1998
	In Billions of Dollars						
Total Deficit Assuming Discretionary Caps	290	266	253	196	190	198	200
Deficit Excluding Deposit Insurance and Desert Storm Contributions	293	292	240	206	200	206	204
Standardized-Employment Deficit[a]	200	211	175	154	160	180	186
On-Budget Deficit (Excluding Social Security and Postal Service)	341	311	311	262	263	276	284
Memorandum:							
Deposit Insurance	3	-26	14	-10	-10	-8	-4
Desert Storm Contributions	-5	0	0	0	0	0	0
Off-Budget Surplus							
Social Security	51	46	59	65	71	77	84
Postal Service	-1	-1	-2	1	2	1	b
Total, Off-Budget Surplus	50	45	57	65	73	78	84
Hospital Insurance Surplus	11	2	5	7	6	2	-3
	As a Percentage of GDP						
Total Deficit Assuming Discretionary Caps	4.9	4.3	3.9	2.9	2.6	2.6	2.5
Deficit Excluding Deposit Insurance and Desert Storm Contributions	5.0	4.7	3.7	3.0	2.8	2.7	2.6
Standardized-Employment Deficit[a, c]	3.2	3.3	2.6	2.2	2.2	2.3	2.3

SOURCE: Congressional Budget Office.

a. Excludes cyclical deficit as well as deposit insurance and Desert Storm contributions.

b. Less than $500 million.

c. Expressed as a percentage of potential GDP.

Box 2-1.
The Ten-Year Budget Outlook

If current policies stay unchanged, the Congressional Budget Office projects that the federal deficit will level off at about $200 billion a year in 1995 through 1998. But after 1998, the gap between revenues and spending begins to widen--reaching $359 billion in 2003. Of greater concern is the deficit's trend as a share of gross domestic product: from 2.5 percent in 1998, it inches up in every year, reaching 3.6 percent of GDP in 2003.

These projections should not surprise participants in the budget debate. Even its most committed advocates did not claim that the recent reconciliation act was a deficit cure-all. Furthermore, a few of the act's provisions were explicitly limited to the 1994-1998 period. In short, CBO's new projections buttress the view that more cuts lie ahead before the deficit fades as an economic problem.

What accounts for the escalating deficits after 1998? Revenues do not provide the answer--they barely slip from 19.4 percent to 19.3 percent of GDP. The search thus turns to the spending side and focuses on the fast-growing health care programs, Medicare and Medicaid. Even after the latest round of savings, there is little reason to expect a reversal of recent trends in health spending; both programs are expected to continue growing at 10 percent or more annually over the next decade, outstripping the growth of the economy. If so, they will climb inexorably as a share of GDP: from 3.5 percent this year to 4.7 percent in 1998 and 6.2 percent in 2003.

No other major category of spending is expected to outpace growth in the economy. Mandatory spending other than that for Medicare and Medicaid is expected to stay roughly constant as a share of GDP. Of course, even in 2003--the last year of this projection--most of the baby-boom generation still must wait a decade or more to collect Social Security benefits. Net interest outlays hardly budge from 3.2 percent of GDP, as the debt's growth is trimmed from previous projections and as interest income--buoyed by a new source, income from direct student loans--gradually climbs.

The Budget Outlook Through 2003 (By fiscal year)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
					In Billions of Dollars						
Revenues	1,150	1,244	1,332	1,403	1,472	1,547	1,617	1,690	1,768	1,848	1,934
Outlays											
Discretionary	547	542	542	548	547	547	564	581	598	616	634
Mandatory											
Social Security	302	319	337	354	372	391	410	431	452	475	499
Medicare	143	160	178	196	216	239	264	292	323	357	395
Medicaid	76	88	100	112	125	139	155	172	190	210	231
Civil Service and Military Retirement	61	63	66	69	72	75	79	83	87	91	95
Other	182	178	174	170	184	191	196	202	208	214	221
Subtotal	764	808	855	901	969	1,035	1,105	1,180	1,260	1,347	1,440
Deposit insurance	-26	14	-10	-10	-8	-4	-4	-4	-3	-3	-3
Net interest	198	203	217	230	242	253	265	278	292	311	327
Offsetting receipts	-67	-70	-74	-76	-80	-85	-89	-93	-97	-102	-107
Total	1,416	1,497	1,529	1,592	1,670	1,747	1,840	1,941	2,050	2,168	2,292
Deficit	266	253	196	190	198	200	223	251	282	320	359
Deficit Excluding Deposit Insurance	292	240	206	200	206	204	228	254	285	323	362
Debt Held by the Public	3,249	3,507	3,713	3,919	4,137	4,357	4,601	4,873	5,176	5,517	5,896

(Continued)

Box 2-1. Continued

A conspicuous exception to the general pattern is discretionary spending. The new lids on discretionary spending freeze outlays in a narrow dollar range through 1998 and thus push this category down relentlessly as a share of GDP--to less than 7 percent in 1998, barely half the typical levels of the 1960s. After 1998, when the caps on discretionary spending expire, CBO simply assumes that this spending keeps pace with inflation. Because this assumption implies that it still lags behind economic growth, discretionary spending slips further as a percentage of GDP, to 6.3 percent in 2003.

Last March, CBO projected that the deficit would top $650 billion, or 6.8 percent of GDP, in 2003.[1] The new projections point to a deficit of about 3.6 percent of GDP in that year, a vast improvement. Remarkably, the single biggest change lies in net interest--now projected at 3.3 percent of GDP in 2003 compared with 4.5 percent in the earlier report, a testimonial to the efforts to rein in the debt's growth. The remaining credit is shared roughly equally by the revenue increases, discretionary spending cuts, and Medicare savings accomplished in 1993's reconciliation package.

Of course, enormous uncertainties surround such long-range extrapolations. The economy's performance is a big question mark; these projections are predicated on continued growth in real GDP of 2.1 percent annually in 1999 through 2003, on inflation of 3 percent, and on short-term and long-term interest rates (specifically, rates on three-month Treasury bills and 10-year Treasury notes) of 4.6 percent and 6.1 percent, respectively. The economy is bound to deviate from these assumptions in ways that cannot be anticipated. And other major uncertainties abound, most notably about the continued spiraling of health care spending and about other open-ended commitments, such as those for deposit insurance.

1. Congressional Budget Office, "An Analysis of the President's February Budgetary Proposals," CBO Paper (March 1993), Appendix.

The Budget Outlook Through 2003 (By fiscal year)

	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003
					As a Percentage of GDP						
Revenues	18.6	19.1	19.4	19.4	19.4	19.4	19.3	19.3	19.3	19.3	19.3
Outlays											
Discretionary	8.8	8.3	7.9	7.6	7.2	6.9	6.7	6.6	6.5	6.4	6.3
Mandatory											
Social Security	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	5.0
Medicare	2.3	2.4	2.6	2.7	2.8	3.0	3.2	3.3	3.5	3.7	3.9
Medicaid	1.2	1.4	1.5	1.5	1.6	1.7	1.9	2.0	2.1	2.2	2.3
Civil Service and Military Retirement	1.0	1.0	1.0	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Other	2.9	2.7	2.5	2.4	2.4	2.4	2.3	2.3	2.3	2.2	2.2
Subtotal	12.3	12.4	12.5	12.5	12.8	13.0	13.2	13.5	13.7	14.0	14.3
Deposit insurance	-0.4	0.2	-0.1	-0.1	-0.1	a	-0.1	a	a	a	a
Net interest	3.2	3.1	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.3
Offsetting receipts	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Total	22.9	23.0	22.3	22.0	22.0	21.9	22.0	22.2	22.4	22.6	22.8
Deficit	4.3	3.9	2.9	2.6	2.6	2.5	2.7	2.9	3.1	3.3	3.6
Deficit Excluding Deposit Insurance	4.7	3.7	3.0	2.8	2.7	2.6	2.7	2.9	3.1	3.4	3.6
Debt Held by the Public	52.5	53.8	54.1	54.3	54.4	54.6	55.0	55.7	56.5	57.5	58.7

SOURCE: Congressional Budget Office.

a. Less than 0.05 percent.

postal transactions affect the economy as much as other governmental spending or receipts.

The Omnibus Budget Reconciliation Act of 1993

CBO estimates that the Omnibus Budget Reconciliation Act of 1993 (OBRA-93) will reduce deficits in 1994 through 1998 by $433 billion compared with CBO's winter 1993 baseline (see Table 2-2). Tax increases account for $241 billion of the five-year savings; direct spending cuts for $77 billion; new limits on discretionary appropriations in 1996, 1997, and 1998 for $69 billion; and debt-service savings for $47 billion. OBRA-93 also included a provision increasing the limit on the public debt to $4.9 trillion (see Box 2-2).

The estimate of the deficit reduction assumes that the President and the Congress will comply with the new discretionary limits when enacting appropriations. The $69 billion in discretionary savings is calculated by subtracting the new limits (including CBO's estimate of required adjustments) for 1996, 1997, and 1998 from CBO's winter baseline projection for discretionary spending in those years. CBO's winter baseline assumed that lawmakers would comply with the 1994 and 1995 discretionary spending limits established by the 1990 reconciliation act and that appropriations would equal the 1995 limit plus inflation after 1995. If the new limits are compared instead with alternative baselines that had not already incorporated the cuts required to reach the 1994 and 1995 limits, the estimated discretionary savings attributed to the new limits would be higher, although the new baseline deficit projections would not be affected.

Revenues

Changes in tax policy under OBRA-93 increase revenues by an estimated $241 billion in 1994 through 1998. The reconciliation act's major tax increases over five years include the following:

- $115 billion from changes in the income tax that affect high-income individuals, including new tax brackets of 36.0 percent and 39.6 percent, an increase in the alternative minimum tax, and the permanent extension of the limitation on itemized deductions and the phaseout of personal exemptions;

- $31 billion from extending through 1999 a tax of 2.5 cents a gallon on gasoline and other motor fuels that was scheduled to expire at the end of 1995, and imposing an additional permanent tax of 4.3 cents a gallon on motor fuels;

- $29 billion from repealing the cap on earnings (now $135,000) subject to the Medicare payroll tax;

- $25 billion from subjecting to the income tax up to 85 percent of an individual's Social Security benefits (the change affects only taxpayers whose other income plus one-half of their Social Security benefits exceeds $34,000 for single filers or $44,000 for joint filers);

- $16 billion from increasing the corporate tax rate to 35 percent for taxable income above $10 million; and

- $15 billion from reducing the deductible portion of business meal and entertainment expenses from 80 percent to 50 percent.

In addition to other, smaller tax increases, OBRA-93 contained a number of revenue-losing provisions, including temporary extension of the credit for research and experimentation and permanent extension of the low-income housing credit; more generous depreciation for certain firms; incentives for investments in empowerment zones and enterprise communities; expansion of the earned income tax credit (EITC); repeal of the luxury excise

Table 2-2.
Major Elements of Deficit Reduction Under OBRA-93 from the CBO Winter 1993 Baseline
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	Five-Year Total
Revenues						
Increase in tax rate for high-income individuals	-15.4	-22.8	-25.7	-24.6	-26.3	-114.8
Extension and increase of motor fuels tax	-4.4	-4.5	-7.4	-7.5	-7.5	-31.3
Repeal of cap on earnings subject to Medicare tax	-2.8	-6.0	-6.4	-6.8	-7.2	-29.2
Increase in taxable portion of Social Security benefits	-1.9	-4.6	-5.3	-6.0	-6.7	-24.6
Increase in corporate tax rate	-4.4	-2.8	-2.9	-3.1	-3.2	-16.4
Reduced business meal and entertainment deduction	-1.8	-3.1	-3.3	-3.4	-3.6	-15.3
Expansion of earned income tax credit	a	0.2	0.4	0.5	0.6	1.7
Other	4.3	0.2	-0.9	-9.8	-4.6	-10.8
Subtotal	-26.4	-43.5	-51.5	-60.7	-58.5	-240.6
Mandatory Spending						
Medicare	-2.1	-5.5	-11.6	-16.4	-20.2	-55.8
Federal employee retirement and health benefits	-0.4	-0.8	-2.9	-3.7	-4.0	-12.0
FCC electromagnetic spectrum auction	-1.7	-1.8	-1.7	-1.0	-1.0	-7.2
Medicaid	a	-1.0	-1.6	-2.1	-2.5	-7.1
Federal Family Education Loans	-0.6	-0.4	-0.8	-1.2	-1.2	-4.3
Veterans' benefits	-0.2	-0.4	-0.4	-0.4	-1.2	-2.6
Farm programs	-0.1	-0.7	-0.5	-0.6	-0.5	-2.5
Refundable earned income tax credit	0.2	2.0	4.4	6.1	6.4	19.1
Food stamps	a	0.2	0.4	0.8	1.0	2.5
Other	-0.3	-0.2	-1.8	-2.4	-2.5	-7.2
Subtotal	-5.3	-8.5	-16.6	-20.9	-25.7	-76.9
Discretionary Spending	0	0	-7.7	-23.0	-37.9	-68.5
Debt Service	-0.9	-3.4	-7.5	-13.6	-21.3	-46.8
Total Deficit Reduction	-32.6	-55.5	-83.3	-118.1	-143.4	-432.9
Memorandum: Deficit Reduction from Alternative Baselines						
Reduction from the CBO Uncapped Baseline[b]	-47.4	-83.2	-111.8	-147.4	-174.5	-564.4
Reduction from the CBO Estimate of the Administration's Baseline[c]	-42.0	-72.9	-94.1	-123.7	-144.3	-476.9

SOURCE: Congressional Budget Office.

NOTES: The CBO winter 1993 baseline assumed compliance with the discretionary spending limits of the Budget Enforcement Act through 1995. Discretionary outlays were assumed to grow at the same pace as inflation after 1995. See Congressional Budget Office, "An Analysis of the President's February Budgetary Proposals," CBO Paper (March 1993).

Revenue increases are shown with a negative sign because they reduce the deficit.

OBRA-93 = Omnibus Budget Reconciliation Act of 1993; FCC = Federal Communications Commission.

a. Less than $500 million.

b. The CBO March 1993 uncapped baseline assumed that discretionary outlays would grow from 1993 appropriated levels at the same pace as inflation through 1998.

c. CBO's estimate of the Administration's baseline assumed that discretionary outlays for nondefense accounts would grow from the 1993 appropriated levels at the same pace as inflation. Defense discretionary outlays equaled the amounts requested in the Bush Administration's January 1992 budget request (with various adjustments by the Clinton Administration).

Box 2-2.
The Debt Ceiling

As part of the Omnibus Budget Reconciliation Act of 1993, the Congress enacted a new statutory limit on federal debt of $4.9 trillion. This action should spare lawmakers another vote on this contentious issue for nearly two years.

Debt subject to limit far exceeds debt held by the public (a much more useful measure of what the government owes), mainly because it includes the holdings of Social Security, Medicare, and other government trust funds. CBO's projections of debt subject to limit through 1998 are presented below. Clearly, although this year's deficit reduction package puts a huge dent in projected deficits, it does not halt the accumulation of debt. So long as the government runs any deficit at all, and so long as trust funds' holdings are included in the statutory measure, policymakers will be forced periodically to raise the dollar limit on debt.

Voting explicitly on the debt is an ineffectual way to control federal borrowing. The key choices are made when voting on spending and revenues, which in turn substantially dictate the Treasury's borrowing needs. But the increase in the reconciliation act was hardly the first time that such a measure has been part of a bigger package that slashed the deficit and revamped the budget process. The original Balanced Budget and Emergency Deficit Control Act of 1985 (better known as Gramm-Rudman-Hollings), its successor in 1987, and the Budget Enforcement Act of 1990 all coincided with interruptions in the debt ceiling.

The latest increase marks the second vote this year on the debt ceiling. In April, a temporary hike in the debt ceiling (to $4,370 billion) was enacted. This increase was valid only through September 30, 1993. Like many such short-term increases, this temporary measure was meant to bring the budgetary debate to a head and thus spur action on a major deficit reduction effort--which the Congress in fact wrapped up in August.

How long will the new ceiling last? Under the Congressional Budget Office's latest projections, debt subject to limit would just top $5 trillion at the end of 1995. Thus, the recent increase to $4.9 trillion is likely to last through most of that fiscal year--probably becoming inadequate in late spring or early summer.

Baseline Projections of Debt Subject to Statutory Limit
(By fiscal year, in billions of dollars)

	1992	1993	1994	1995	1996	1997	1998
Debt Subject to Limit, Start of Year	3,569	3,973	4,308	4,677	5,006	5,345	5,701
Changes							
Deficit	290	266	253	196	190	198	200
Trust fund surplus	96	90	106	117	127	131	134
Other changes[a]	17	-20	10	15	22	26	23
Total	403	336	369	328	339	356	358
Debt Subject to Limit, End of Year	3,973	4,308	4,677	5,006	5,345	5,701	6,058

SOURCE: Congressional Budget Office.

a. Primarily changes in Treasury cash balances, investments by government funds (such as the Bank Insurance Fund) that are not trust funds, and activity of the credit financing accounts.

tax on boats, aircraft, jewelry, and furs; and reduction of the luxury excise tax on automobiles.

CBO estimates that over 80 percent of the net tax increase from OBRA-93 will be paid by families with incomes of at least $200,000, and over 90 percent by families with incomes of at least $100,000 (see Table 2-3). Two provisions that affect only families with incomes of $100,000 or more--changes in individual income tax rates and the elimination of the cap on wages subject to the Medicare payroll tax--account for nearly two-thirds of the net increase in revenues. CBO estimates that high-income families will also bear a large share of the burden of increases in the corporate income tax. The OBRA-93 tax changes will bring the effective tax rate on the 1 percent of families with the highest incomes to its highest level since 1979.

By 1996, when the expansion of the earned income tax credit is fully phased in, the average family with income under $30,000 will pay less tax than if OBRA-93 had not been enacted. For the average family in this category, the increase in the EITC (including the refundable portion that is treated as an outlay for budgetary purposes) will be larger than the added fuel taxes. OBRA-93 will raise the EITC for families with two or more children, increase the income level at which eligibility for the credit ceases, and expand the credit to include childless households. When these changes are fully phased in, the effective tax rate on the 20 percent of families with the lowest incomes will be less than half its 1985 level and lower than it has been for at least 16 years.

For families with incomes between $30,000 and $50,000, OBRA-93's higher motor fuel taxes will have the greatest impact--about $62 a year for the average family in this category. Families with incomes between $50,000 and $100,000 will be affected almost equally by the taxation of Social Security benefits, the increases in the motor fuels tax, and the increase in corporate taxes.

Because OBRA-93's increases in the marginal income tax rate are substantial but apply only to a small share of taxpayers, the estimates of revenue gains are more uncertain than are estimates of smaller tax increases that apply more uniformly to the entire population. This uncertainty stems from two sources. First, the share of total income reported by the highest-income taxpayers varies considerably from year to year even when there are no changes in tax rates. Thus, forecasts of the tax base to which the higher OBRA-93 rates apply are uncertain. Second, the new rates themselves probably affect the tax base; high-income taxpayers may respond to higher tax rates by working less, taking more of their compensation in tax-free or tax-advantaged forms, adjusting their asset portfolios, or converting ordinary income to capital gains.

Official revenue estimates attempt to take into account many of these behavioral responses. Some analysts have suggested, however, that the behavioral response will be much larger than official estimates assume and could even wipe out most of the estimated revenue gain. Although the extent of the behavioral response is uncertain, CBO's current assessment is that it is likely to offset a small share of the revenue increase that would otherwise occur.

Direct Spending

Changes in direct spending policy in OBRA-93 reduce the deficit by $77 billion in 1994 through 1998 (see Table 2-2 on page 29). The major cuts in mandatory programs include the following:

- $56 billion from Medicare, primarily from reducing payments to hospitals, physicians, and other providers but including $8 billion from requiring Medicare premiums to cover 25 percent of the costs for Supplementary Medical Insurance (Medicare Part B) in 1996, 1997, and 1998;

Table 2-3.
Changes in Taxes Under the Omnibus Budget Reconciliation Act of 1993, by Income Group

	Change in Taxes		Percentage Change in	Effective Tax Rates		Share
	Average (Dollars)	Percentage Change	After-Tax Income	Before OBRA-93	After OBRA-93	of Change in Taxes
	Families Ranked by Adjusted Family Income					
Income Quintile						
Lowest	-166	-28.1	2.1	7.0	5.0	-8.3
Second	-35	-1.1	0.2	15.0	14.9	-1.8
Third	64	1.0	-0.2	19.3	19.5	3.2
Fourth	110	1.0	-0.3	22.1	22.3	5.7
Highest	1,884	6.5	-2.3	26.2	27.9	100.9
All	382	3.8	-1.1	22.8	23.7	100.0
Detail on Highest Quintile						
81 percent to 90 percent	239	1.4	-0.5	24.6	24.9	6.3
91 percent to 95 percent	388	1.7	-0.6	25.9	26.3	5.3
96 percent to 99 percent	1,177	3.3	-1.2	26.8	27.7	13.1
Top 1 percent	29,417	18.5	-7.2	28.0	33.2	76.3
	Families Ranked by Dollar Income					
Income Level						
Less than $10,000	-68	-14.9	1.2	7.5	6.4	-2.5
$10,000 to $20,000	-86	-5.0	0.6	11.5	10.9	-3.9
$20,000 to $30,000	-41	-1.0	0.2	16.9	16.8	-1.7
$30,000 to $40,000	50	0.7	-0.2	19.8	19.9	1.6
$40,000 to $50,000	105	1.1	-0.3	21.6	21.8	2.7
$50,000 to $75,000	192	1.3	-0.4	23.4	23.7	7.8
$75,000 to $100,000	312	1.4	-0.5	25.2	25.5	5.6
$100,000 to $200,000	649	1.9	-0.7	26.1	26.6	8.8
$200,000 or more	23,521	17.4	-6.7	27.9	32.7	81.3
All	382	3.8	-1.1	22.8	23.7	100.0

SOURCE: Congressional Budget Office.

NOTES: The estimates assume 1998 tax law and 1994 income levels. They reflect both the revenue and outlay portion of the earned income tax credit. Before OBRA-93, 1998 tax law would have differed from 1994 tax law because of the scheduled expiration of the limitation on itemized deductions, the phaseout of personal exemptions, and the 2.5 cent component of the gasoline tax that goes into the general fund. The estimates exclude the provisions of OBRA-93 relating to enterprise zones, estimated income tax payments, improved tax compliance, and the temporary extension of the federal unemployment surtax.

Pretax family income is the sum of wages, salaries, self-employment income, rents, taxable and nontaxable interest, dividends, realized capital gains, pensions, and all cash transfer payments. Income also includes the employer's share of Social Security and federal unemployment insurance payroll taxes, and the corporate income tax. For purposes of ranking by adjusted family income, income for each family is divided by the projected 1994 poverty threshold for a family of that size. Quintiles contain equal numbers of people. Individuals are treated as families of one. Families with zero or negative income are excluded from the lowest income category but are included in the total.

Changes in individual income taxes are distributed directly to families paying those taxes. Changes in payroll taxes are distributed to families paying those taxes directly, or indirectly through their employers. Changes in federal excise taxes are distributed to families according to their consumption of the taxed good or service. Changes in corporate income taxes are distributed to families according to their income from capital.

- $12 billion from delaying cost-of-living adjustments for military and civil service retirees, permanently eliminating the lump-sum payment option for most federal retirees, and other changes that affect retirement and health benefits for federal employees;

- $7 billion from the Federal Communications Commission's auction of licenses for commercial use of a portion of the electromagnetic spectrum previously reserved for the government;

- $7 billion from Medicaid, primarily from repealing the requirement that states provide personal care services (but leaving states the option to cover such services under Medicaid) and limiting additional payments to hospitals serving large numbers of low-income or uninsured patients;

- $4 billion from changes in the Federal Family Education Loan program (formerly known as the Guaranteed Student Loan, or GSL, program), including a transition to a Federal Direct Student Loan program that is intended to handle 60 percent of loan volume by the 1998-1999 school year;

- $3 billion from a variety of provisions affecting programs of the Department of Veterans Affairs, including higher origination fees on VA-guaranteed loans, the extension through 1998 of the current authority to collect payments from commercial insurers for medical services provided by the VA to privately insured individuals, and a limitation on VA pensions to beneficiaries of nursing home care covered by Medicaid; and

- $2 billion from limiting the ratio of losses to premiums in the crop insurance program, increasing minimum acreage set-asides, and other changes in farm programs.

OBRA-93 achieved other, smaller savings by requiring the Department of Housing and Urban Development to use Internal Revenue Service data to verify the income of beneficiaries of assisted housing, capping the number of acres enrolled in the conservation and wetlands reserve programs, and imposing or increasing a number of user fees. The savings in direct spending are partially offset by $19 billion in additional spending for the refundable portions of the earned income tax credit, which is considered an outlay (the EITC liberalization also reduced revenues by $2 billion); $2 billion in increased spending for the Food Stamp program; and increases in a few other programs.

Discretionary Spending

New discretionary spending limits for 1996, 1997, and 1998 included in OBRA-93 have reduced estimated discretionary spending by $69 billion in 1994 through 1998, relative to CBO's winter 1993 baseline. Estimated savings are larger if the level of spending allowed under the new caps is compared with baselines that, unlike CBO's baseline, do not assume compliance with the discretionary caps for 1994 and 1995 that were established by the Budget Enforcement Act of 1990 (see Box 2-3).

Changes in the Budget Outlook Since March

CBO last presented its budget projections in March 1993, in conjunction with its analysis of President Clinton's February 17, 1993, budgetary proposals. The budget estimates have changed since then, primarily because of the enactment of OBRA-93. Other legislation and revisions in CBO's economic forecast and technical assumptions have had a much smaller effect on projections of spending, revenues, and deficits (see Table 2-4).

Policy Changes

CBO categorizes the reestimates that result from legislation enacted since the previous baseline as policy changes. Such changes dominate the current reestimates because of the impact of OBRA-93, which has just been discussed. Other legislation has had relatively little effect on CBO's budgetary estimates. Two measures that provide emergency funding not subject to the discretionary spending limits or the pay-as-you-go constraints on direct spending and receipts account for almost all of the remaining policy changes. A supplemental appropriation bill providing funding for flood relief in the Midwest was enacted in early August, increasing discretionary spending in 1993 through 1998 by nearly $6 billion. A bill enacted in early March that extended unemployment benefits increased direct spending by $6 billion in 1993 and 1994.

Economic Changes

Revisions to CBO's economic forecast have generated little change in projected deficits for 1993 through 1998. The differences between the summer and winter forecasts are slight, and two of the more significant differences have offsetting effects: a somewhat lower level of real gross domestic product through 1997 tends to drive up deficits, but lower long-term

Box 2-3.
Alternative Baseline Concepts

There is no single correct estimate of the magnitude of savings in discretionary spending provided by the Omnibus Budget Reconciliation Act of 1993 (OBRA-93). An estimate is made by comparing the spending allowed under the discretionary spending limits in effect under the reconciliation act (including CBO's estimate of required adjustments to the caps) with prior baseline projections of discretionary outlays. Different estimates arise because three alternative discretionary baseline concepts were used in budget deliberations this year, providing three possible starting points for estimates of the savings under the reconciliation act.

- o **CBO (Capped) Baseline**. CBO's estimate of $69 billion in discretionary cuts over the 1994-1998 period uses as its starting point the CBO winter 1993 baseline, which assumed that discretionary spending would comply with the caps established by the Budget Enforcement Act of 1990 for 1994 and 1995 and would grow at the same pace as inflation thereafter.

- o **CBO Uncapped Baseline**. One alternative starting point is an uncapped baseline, developed by CBO at the same time as the winter baseline, which assumed that discretionary spending in the 1994-1998 period would grow at just the rate of inflation.

- o **Administration's Baseline**. The Clinton Administration's budget for 1994 introduced a baseline concept in which nondefense discretionary spending would keep pace with inflation, but defense spending would be held to the levels proposed in the Bush Administration's January 1992 budget request (with various adjustments).

Because the 1994 and 1995 discretionary caps are lower than the amounts needed to provide the same real level of funding as in 1993, discretionary spending for the 1994-1998 period in CBO's winter (capped) baseline was $114 billion below that in the uncapped baseline. This difference in discretionary spending affected debt-service costs, which pushed the difference between total outlays in the two baselines to $131 billion over the five years. CBO's estimate of discretionary spending using the Administration's baseline concept was $78 billion below the uncapped baseline over five years but $36 billion above the capped version. Including debt service, CBO's winter (capped) baseline was $44 billion lower than CBO's estimate of spending in the Administration's baseline. The effect of using the alternative baselines as the starting point in estimating total deficit reduction produced by OBRA-93 is shown in the table at right.

CBO's winter 1993 baseline assumed compliance with the 1994 and 1995 caps because they represented a clear statement of policy concerning aggregate discretionary spending and because experience since 1990 suggests that actual discretionary spending will be close to the cap levels. However, the decision to limit discretionary spending to the stated cap amounts in 1994 and 1995 was not accompanied by any plan detailing specific program-by-program spending levels to accomplish the stated goals. Thus, the political repercussions of holding discretionary spending to the 1994 and 1995 caps, as well as to the new caps for 1996 through 1998, will be manifest only as the actual appropriations for each year are enacted and the real programmatic effects of complying with the new caps become apparent. Comparing the new caps with the spending needed to maintain current program activity levels in the face of inflation--the uncapped baseline--offers a measure of the required cuts in programs and the difficulty of complying with the caps.

interest rates have an opposite, and larger, effect. Although inflation is expected to be slightly higher throughout the period, changes in inflation have little impact on the deficit because they tend to push up revenues and spending by roughly equal amounts.

Technical Changes

Changes in estimates that are not attributable to legislation or revisions in the economic forecast are called technical reestimates. An almost infinite number of factors can cause such changes in projections of tax collections or spending, ranging from unexpected weather that affects the costs of farm programs to administrative actions that increase spending for entitlement benefits.

In contrast to recent experience, the technical changes to the winter baseline incorporated in this report drive deficits down. Reestimates of deposit insurance spending are once again a major part of the technical changes, with substantial year-to-year shifts and a reduction in total spending during the six-year period of more than $20 billion. In a

Deficit Reduction Under OBRA-93 from Alternative Baselines
(By fiscal year, in billions of dollars)

	1994	1995	1996	1997	1998	Five-Year Total
Reduction from CBO's March 1993 Capped Baseline[a]	-33	-56	-83	-118	-143	-433
Additional Reductions from CBO's Estimate of the Administration's Baseline						
Discretionary spending	-9	-16	-9	-3	2	-36
Debt service	b	-1	-2	-2	-3	-8
Total	-9	-17	-11	-6	-1	-44
Reduction from CBO's Estimate of the Administration's Baseline	-42	-73	-94	-124	-144	-477
Additional Reductions from CBO's March 1993 Uncapped Baseline						
Discretionary spending	-5	-10	-16	-21	-26	-78
Debt service	b	-1	-1	-3	-4	-9
Total	-5	-10	-18	-24	-30	-87
Reduction from CBO's March 1993 Uncapped Baseline	-47	-83	-112	-147	-175	-564

SOURCE: Congressional Budget Office.

a. Includes $69 billion in discretionary savings over five years.

b. Less than $500 million.

departure from recent baseline revisions, technical changes have reduced estimates of spending for Medicare and Medicaid and boosted revenues.

Deposit Insurance. The volatility of expenditures for deposit insurance is reflected in the current reestimates. Estimated outlays are down by more than $18 billion in 1993 but increase by about $10 billion in 1994 (see Table 2-4). The volatility is most evident in estimates of S&L-related spending by the Resolution Trust Corporation (RTC) and its successor, the Savings Association Insurance Fund (SAIF). CBO presents that spending on a combined basis because of uncertainty about whether the September 30, 1993, deadline on RTC's acceptance of new cases will be

Table 2-4.
Changes in CBO's Deficit Estimates Since March 1993 (By fiscal year, in billions of dollars)

	1993	1994	1995	1996	1997	1998
March 1993 Estimate	302	287	284	290	322	360
Policy Changes						
Reconciliation	0	-33	-55	-83	-118	-143
Other legislation	4	6	2	1	1	1
Subtotal	4	-26	-54	-82	-117	-143
Economic Changes						
Revenues	1	1	4	7	4	-5
Net interest	-1	-6	-10	-11	-12	-15
Other outlays	a	a	3	5	6	8
Subtotal	a	-5	-3	1	-2	-11
Technical Changes						
Revenues	-10	-4	-3	-3	-2	-3
Outlays						
Bank Insurance Fund[b]	-7	-5	-4	-2	1	6
S&L-related outlays[b, c]	-12	15	-14	-7	5	1
Medicaid	-4	-4	-4	-4	-5	-5
Medicare	-4	-5	-5	-3	-3	-3
Income security[d]	1	2	3	2	3	3
Shortening of debt maturities	a	-1	-1	-1	-2	-2
Debt service	-1	-2	-3	-4	-4	-4
Other	-3	a	a	3	2	2
Subtotal	-39	-2	-31	-19	-5	-6
Total	-36	-33	-88	-100	-124	-160
Current Estimate	266	253	196	190	198	200

SOURCE: Congressional Budget Office.

NOTES: Revenue losses are shown with a positive sign because they increase the deficit.

S&L = savings and loan.

a. Less than $500 million.

b. Net of interest payments to the Federal Financing Bank. These payments are intrabudgetary and do not affect the total deficit.

c. Includes the Resolution Trust Corporation, the Savings Association Insurance Fund, and the FSLIC Resolution Fund.

d. Primarily food stamps, Supplemental Security Income, and the earned income tax credit.

extended and because total spending is not significantly affected by which agency is responsible for new resolutions after that date.

CBO's winter 1993 estimates of RTC and SAIF spending assumed that legislation to fund S&L-related spending would be enacted in the spring, but the Congress has not yet completed action on it. CBO assumes that funding will be enacted this fall for RTC and SAIF activities for two reasons: funding must eventually be provided to meet existing commitments to savings and loan depositors, and such funding is exempt from pay-as-you-go procedures that require cuts in other spending or tax increases to offset new spending. The delay in funding is largely responsible for a reduction of nearly $12 billion in estimated S&L-related spending in 1993 and a $15 billion increase in 1994. In addition to shifting spending from year to year, delays in funding that would allow regulators to shut down currently insolvent thrifts increase the eventual cost of those closures.

Despite the increased costs imposed by the funding hiatus, total S&L-related spending, which includes continuing expenditures by the FSLIC Resolution Fund related to thrifts closed by the Federal Savings and Loan Insurance Corporation before its demise in 1989, is down more than $12 billion over the 1993-1998 period. This drop reflects improvement in the overall health of the industry that is largely attributable to the favorable interest rate climate. Thrifts can raise funds at current low short-term rates while their portfolios continue to reflect higher rates for long-term loans and investments. As a result, fewer institutions are expected to fail during the next five years. Recent legislation and regulatory reforms have also prompted many thrifts to take steps to improve their capital positions and to control and reduce risk. Furthermore, the drop in long-term interest rates has increased the value of loan assets--primarily mortgages with relatively high interest rates--of institutions that have already or are expected to become insolvent over the 1993-1998 period, thereby decreasing RTC's and SAIF's resolution costs.

Nonetheless, the estimate of S&L-related spending remains highly uncertain because of the unpredictability of funding for RTC and SAIF and the possibility that a number of the more profitable thrifts may opt out of the industry by switching to bank charters. Such switching will be increasingly tempting if, as CBO anticipates, premiums of the Bank Insurance Fund (BIF) are cut in 1997 and premiums for SAIF are maintained at current levels.

Net spending by the Bank Insurance Fund in 1993 through 1998 is also lower--by $10 billion--largely because of the effect of favorable interest rates on the health of the banking industry. The improved condition of the industry has allowed BIF to pay off the remaining loans from the Federal Financing Bank that had been needed to meet demands on the fund. CBO anticipates that premiums assessed on banks will be sufficient to support the fund for the foreseeable future. Moreover, CBO estimates that the target for BIF's capitalization (the ratio of reserves to insured deposits) will be achieved in 1997, permitting premiums to drop from 25 cents to around 9 cents per $100 of deposits. This anticipated premium cut generates an increase in estimated net BIF outlays for that year.

Medicare and Medicaid. Unanticipated growth in Medicare and Medicaid in recent years has regularly caused large technical changes in CBO's deficit projections. Increased estimates of Medicare and Medicaid spending contributed to the failure of the 1990 budget agreement to slow spending growth and rein in deficits--a failure that has led to widespread criticism of that agreement.

Spending on Medicare and Medicaid is once again subject to significant technical revisions, but this time the technical changes produce lower estimates of spending for these two programs. Lower-than-anticipated payments to physicians under Medicare's Supplementary Medical Insurance have pushed estimated spending for Medicare about $4 billion below winter baseline estimates for 1993. This reduction probably results from a somewhat unexpected response by some physicians

Table 2-5.
Baseline Budget Projections, Assuming Compliance with Discretionary Spending Caps (By fiscal year)

Category	Actual 1992	1993	1994	1995	1996	1997	1998
			In Billions of Dollars				
Revenues							
Individual income	476	512	545	593	628	661	699
Corporate income	100	115	126	132	136	143	149
Social insurance	414	428	465	495	521	547	573
Other	101	96	107	113	117	121	126
Total	1,090	1,150	1,244	1,332	1,403	1,472	1,547
On-budget	788	839	907	976	1,027	1,076	1,131
Off-budget	302	312	337	357	376	395	415
Outlays							
Defense discretionary	303	294	a	a	a	a	a
International discretionary	19	21	a	a	a	a	a
Domestic discretionary	214	231	a	a	a	a	a
Subtotal	536	547	542	542	548	547	547
Mandatory spending, excluding deposit insurance	712	764	808	855	901	969	1,035
Deposit insurance	3	-26	14	-10	-10	-8	-4
Net interest	199	198	203	217	230	242	253
Offsetting receipts[b]	-69	-67	-70	-74	-76	-80	-85
Total	1,381	1,416	1,497	1,529	1,592	1,670	1,747
On-budget	1,129	1,149	1,217	1,237	1,289	1,353	1,416
Off-budget	252	267	280	291	303	317	331
Deficit	290	266	253	196	190	198	200
On-budget deficit	341	311	311	262	263	276	284
Off-budget surplus	50	45	57	65	73	78	84
Debt Held by the Public	2,999	3,249	3,507	3,713	3,919	4,137	4,357

(Continued)

SOURCE: Congressional Budget Office.

a. Discretionary spending caps are specified by category through 1993 and in the aggregate for 1994 through 1998.

to new methods for determining reimbursement rates that were enacted in 1989 and went into effect on January 1, 1992. Those physicians who have received higher payments for procedures under the new rules have reduced the volume of procedures they performed. This reduction was not anticipated when the reimbursement rates were set. Unless physicians' behavior changes, reductions close to the 1993 figure should occur each year through 1998.

The Medicaid program is operated by the individual states; the federal government sets standards and provides matching payments. Federal expenditures are therefore affected by the behavior of the states, as well as by changes in eligible populations and the vagaries of the health care delivery system. The unanticipated explosion of Medicaid costs in the early 1990s was caused partly by the states' successful attempts to boost federal reimbursements by arranging for increased tax collections or donations from hospitals and other providers that received higher Medicaid payments. These actions effectively raised the federal matching rate to 100 percent for certain Medicaid payments by the states.

Legislation enacted in 1991 to limit states' use of these schemes, along with uncertainty about how to interpret the legislation, seems to have restrained the growth in federal payments to the states in 1993. CBO has lowered

**Table 2.5.
Continued**

Category	Actual 1992	1993	1994	1995	1996	1997	1998
	As a Percentage of GDP						
Revenues							
Individual income	8.1	8.3	8.4	8.6	8.7	8.7	8.8
Corporate income	1.7	1.9	1.9	1.9	1.9	1.9	1.9
Social insurance	7.0	6.9	7.1	7.2	7.2	7.2	7.2
Other	1.7	1.6	1.6	1.6	1.6	1.6	1.6
Total	18.6	18.6	19.1	19.4	19.4	19.4	19.4
On-budget	13.4	13.6	13.9	14.2	14.2	14.2	14.2
Off-budget	5.2	5.0	5.2	5.2	5.2	5.2	5.2
Outlays							
Defense discretionary	5.2	4.8	a	a	a	a	a
International discretionary	0.3	0.3	a	a	a	a	a
Domestic discretionary	3.6	3.7	a	a	a	a	a
Subtotal	9.2	8.8	8.3	7.9	7.6	7.2	6.9
Mandatory spending, excluding deposit insurance	12.1	12.3	12.4	12.5	12.5	12.8	13.0
Deposit insurance	c	-0.4	0.2	-0.1	-0.1	-0.1	c
Net interest	3.4	3.2	3.1	3.2	3.2	3.2	3.2
Offsetting receipts[b]	-1.2	-1.1	-1.1	-1.1	-1.1	-1.1	-1.1
Total	23.5	22.9	23.0	22.3	22.0	22.0	21.9
On-budget	19.2	18.6	18.7	18.0	17.8	17.8	17.7
Off-budget	4.3	4.3	4.3	4.2	4.2	4.2	4.1
Deficit	4.9	4.3	3.9	2.9	2.6	2.6	2.5
On-budget deficit	5.8	5.0	4.8	3.8	3.6	3.6	3.6
Off-budget surplus	0.9	0.7	0.9	1.0	1.0	1.0	1.1
Debt Held by the Public	51.1	52.5	53.8	54.1	54.3	54.4	54.6

b. Includes contributions from allied nations for Operation Desert Storm of $5 billion in 1992.

c. Less than 0.05 percent.

its estimates of federal Medicaid spending by close to $5 billion a year from 1993 through 1998 as a result of the slower growth experienced in 1993. The reestimates for 1994 through 1998 would have been slightly larger if they had been based solely on the 1993 data. Final regulations issued in August that clarify how to implement the 1991 law are not as constraining as preliminary versions; the 1994-1998 reestimates are therefore slightly lower than the 1993 downturn would otherwise suggest.

Income Security. Estimated spending for 1993 through 1998 for a number of income security programs--primarily food stamps, Supplemental Security Income, and the refundable portion of the earned income tax credit--has increased by an average of $2 billion a year. These reestimates reflect the expected rise in demand resulting from such factors as an increase in the number of households headed by women.[2]

Net Interest. The only other category of spending subject to a significant technical reestimate is net interest. Part of the reestimate is generated by changes the Treasury is

2. See Congressional Budget Office, "Forecasting AFDC Caseloads, with an Emphasis on Economic Factors," CBO Staff Memorandum (July 1993).

making in how it manages federal debt.[3] The Treasury announced plans in May 1993 that would reduce sales of 30-year bonds by almost $15 billion a year below CBO's earlier projections and would eliminate sales of seven-year notes, which had been issued at the rate of almost $40 billion a year. Because the Treasury will instead borrow these amounts in relatively short-term markets--Treasury bills and two- and three-year Treasury notes--at lower interest rates, CBO has estimated that the new approach to debt management will cut net interest costs by $100 million in 1993 and by an additional $6.4 billion in 1994 through 1998 (see Table 2-4 on page 36).

The President's budget, as well as the Congressional budget resolution for 1994 and Budget Committee estimates of OBRA-93, included $16.4 billion in deficit reduction from an unspecified shortening of debt maturities. Because any savings from debt management will result from an exercise of administrative discretion rather than changes in law or economic factors, CBO categorizes its estimate of the savings as a technical change. CBO also includes as a technical reestimate a $2.5 billion reduction in net interest over five years stemming from the Treasury's reduction (from 6 percent to 4 percent) in the guaranteed interest rate on savings bonds, aligning it more closely with market rates. The remaining technical reestimate to net interest is simply the effect of all the other technical reestimates, which reduce the deficit, on the costs of servicing the debt.

Revenues. Increases in tax collections this year that cannot be explained by changes in economic indicators have generated a $10 billion technical boost in CBO's estimate of 1993 revenues. Estimates of revenues through 1998 have also been raised, though by smaller amounts because two of the factors that increased 1993 revenues--corporate income taxes rebounding from the recession more quickly than anticipated and tax withholding growing faster than wages in recent months--are expected to be temporary.

3. See Congressional Budget Office, *Federal Debt and Interest Costs* (May 1993).

The Updated Outlook

Federal revenues climb from $1,150 billion in 1993 to $1,547 billion in 1998 (see Table 2-5 on page 38). As a share of GDP, they increase from 18.6 percent in 1993 to 19.4 percent in 1995 as a result of the new taxes enacted in OBRA-93, and then level off.

Discretionary outlays are essentially frozen at the 1993 level through 1998 by the caps on total discretionary spending in effect in the wake of OBRA-93. Adjusted for inflation, discretionary spending in 1998 is about 14 percent lower than in 1993. Discretionary spending, which equaled 14.4 percent of GDP in 1968, declines from 8.8 percent of GDP in 1993 to 6.9 percent in 1998.

Mandatory spending is by far the largest and most rapidly growing category of spending, totaling $764 billion in 1993 and $1,035 billion in 1998. (The major components of mandatory spending are shown in Table 2-6.) Mandatory spending is growing at an average annual rate of 6.3 percent, outstripping the growth rate of nominal GDP by 1.1 percentage points. The two fastest-growing programs--Medicaid and Medicare--more than account for the growth relative to GDP. Those two programs together grow at an average annual rate of 11.6 percent from 1993 through 1998, increasing from 3.5 percent of GDP in 1993 to 4.7 percent in 1998. All other mandatory programs combined grow at an average annual rate of less than 4 percent and decline relative to GDP.

Deposit insurance spending displays the usual ups and downs in the early years of the projection period. After 1994, however, the projection is for steady, small negative outlays as a result of reduced caseloads and the disposition of assets acquired in the course of earlier resolutions (see Table 2-7). By 1998, pro-

Table 2-6.
CBO Baseline Projections for Mandatory Spending, Excluding Deposit Insurance (By fiscal year, in billions of dollars)

	Actual 1992	1993	1994	1995	1996	1997	1998
			Means-Tested Programs				
Medicaid	68	76	88	100	112	125	139
Food Stamps[a]	23	25	25	25	26	27	28
Supplemental Security Income	18	21	25	24	24	29	31
Family Support	16	17	17	18	18	19	20
Veterans' Pensions	4	3	3	3	3	3	3
Child Nutrition	6	6	7	7	8	8	9
Earned Income Tax Credit	8	10	11	16	19	22	22
Student Loans[b]	2	2	2	2	2	2	2
Other	3	3	3	3	4	4	4
Total	146	163	182	200	216	238	258
			Non-Means-Tested Programs				
Social Security	285	302	319	337	354	372	391
Medicare	129	143	160	178	196	216	239
Subtotal	414	445	479	515	550	589	630
Other Retirement and Disability							
Federal civilian[c]	37	39	41	43	45	48	51
Military	24	26	27	28	29	30	32
Other	5	5	5	5	5	5	5
Subtotal	67	70	73	76	79	83	88
Unemployment Compensation	37	36	28	25	25	25	25
Other Programs							
Veterans' benefits[d]	16	16	17	17	16	18	18
Farm price supports	9	15	10	9	9	9	9
Social services	5	5	6	6	6	5	6
Credit reform liquidating accounts	4	3	1	-2	-8	-5	-6
Other	13	12	11	9	8	8	8
Subtotal	47	51	46	39	30	35	35
Total	565	601	626	655	685	732	778
			Total				
All Mandatory Spending, Excluding Deposit Insurance	712	764	808	855	901	969	1,035

SOURCE: Congressional Budget Office.

NOTE: Spending for major benefit programs shown in this table includes benefits only. Outlays for administrative costs of most benefit programs are classified as nondefense discretionary spending; Medicare premium collections are classified as offsetting receipts.

a. Includes nutrition assistance to Puerto Rico.

b. Includes Stafford loans, Supplemental Loans for Students (SLS), Parent Loans for Undergraduate Students (PLUS), and the new Federal Direct Student Loan program.

c. Includes Civil Service, Foreign Service, Coast Guard, and other retirement programs, and annuitants' health benefits.

d. Includes veterans' compensation, readjustment benefits, life insurance, and housing programs.

Table 2-7.
Outlays for Deposit Insurance in the Baseline (By fiscal year, in billions of dollars)

	Estimate 1992	1993	1994	1995	1996	1997	1998
			Savings-and-Loan-Related				
Resolution Trust Corporation and Savings Association Insurance Fund							
Insurance losses[a]	10	2	21	3	3	2	2
Working capital							
Disbursements	21	8	19	4	3	3	2
Receipts	-43	-31	-21	-12	-10	-7	-4
Interest costs	3	1	1	1	b	b	b
Insurance premiums	b	-1	-1	-1	-1	-1	-1
Total	-9	-20	19	-5	-5	-2	-1
FSLIC Resolution Fund	8	2	1	1	b	b	b
			Bank-Related and Other				
Bank Insurance Fund							
Losses	c	3	2	2	2	2	2
Working capital	c	4	4	5	5	5	5
Liquidations	-10	-11	-7	-6	-6	-7	-7
Net interest	b	b	b	-1	-1	-1	-1
Other outlays (Net)	-4	-5	-5	-6	-6	-6	-2
Total	4	-9	-6	-5	-5	-6	-2
Other[d]	b	b	b	b	b	b	b
			Total				
Total Outlays for Deposit Insurance	3	-26	14	-10	-10	-8	-4

SOURCE: Congressional Budget Office.

NOTE: The Resolution Trust Corporation (RTC) is currently scheduled to stop accepting new cases after September 30, 1993, and turn over responsibility for future resolutions to the Savings Association Insurance Fund. However, because of delays in the RTC's cleanup efforts, significant losses will persist after the transfer date. Thus, the Congress may extend RTC's lifetime (as it has done once already). CBO presents the estimates on a combined basis.

The estimates assume the provision of additional resources to the RTC or its successor beyond those available under current law.

a. Includes administrative costs of less than $500 million a year.

b. Less than $500 million.

c. Total resolution outlays in 1992 were $19 billion. The distribution between losses and working capital is not available.

d. Primarily National Credit Union Administration.

jected net outlays for deposit insurance will be only negative $4 billion. Offsetting receipts, which are counted as negative outlays for budgetary purposes, increase at about the same rate as GDP.

Net interest increases from $198 billion in 1993 to $253 billion in 1998, but does not grow relative to the size of the economy (see Table 2-5 on page 38). It equals a steady 3.2 percent of GDP through most of the period. This stability represents a significant change from CBO's winter baseline, in which net interest climbed to 3.7 percent of GDP in 1998. The combination of savings in debt-service costs from the deficit reduction provided by OBRA-93 and lower interest rates have stabilized net interest, reducing the contribution of spiraling interest costs to rising deficits.

The Federal Sector of the National Income and Product Accounts

The projections described so far in this chapter use categories--revenues by source, outlays by category, total deficits--that are familiar to policymakers. Economists, though, often use another approach for describing the government's activities. The national income and product accounts (NIPAs) recast the government's transactions into categories that affect gross domestic product, income, and other macroeconomic aggregates, thereby helping to trace the relationship between the federal sector and other areas of the economy.

A handful of major differences distinguish the NIPA versions of federal receipts and expenditures from their budget counterparts. Netting and grossing adjustments move selected offsets against outlays from the spending to the receipts side of the NIPAs (see Table 2-8). The budget records these receipts as negative outlays because they are not deemed to result from the government's power to tax. To portray a more comprehensive measure of receipts from all sources, the NIPAs shift these negative outlays from the expenditures to the receipts side. This shift does not affect the deficit.

Foremost among netting and grossing adjustments are intrabudgetary receipts for retirement contributions on behalf of federal workers ($54 billion in 1993) and voluntary premiums for Medicare coverage ($16 billion in 1993). Deposit insurance premiums also contribute to the netting and grossing adjustment to the tune of $6 billion to $8 billion per year until 1998, when CBO anticipates a reduction in the premiums levied on commercial banks.

Excluding lending and financial transactions, in contrast, causes the NIPA deficit to diverge from its budget counterpart. The NIPA totals disregard transactions that involve the transfer of existing assets and liabilities and that therefore do not contribute to current income and production. Huge outlays for deposit insurance have dominated this category in recent years. Other, relatively small factors driving a wedge between budget and NIPA accounting include timing adjustments and geographical differences (the exclusion of Puerto Rico, the Virgin Islands, and a few other areas from the national economic statistics).

The NIPA federal sector generally portrays receipts according to their source and expenditures according to their purpose and destination. Table 2-9 divides receipts and expenditures into their NIPA categories.

The leading source of receipts for the federal government in the 1993-1998 period is taxes and fees paid by individuals. Following this category closely are contributions (including premiums) for social insurance such as Social Security, Medicare, and federal employees' retirement. Both sources are expected to top $500 billion in 1993. The remaining categories are corporate profits tax accruals, including the earnings of the Federal Reserve System, and indirect business tax and nontax accruals (chiefly excise taxes and fees).

Table 2-8.
Relationship of the Budget to the Federal Sector of the National Income and Product Accounts (By fiscal year, in billions of dollars)

	Actual 1992[a]	1993	1994	1995	1996	1997	1998
			Receipts				
Revenues (Budget basis)[b]	1,090	1,150	1,244	1,332	1,403	1,472	1,547
Differences							
Netting and grossing							
Government contributions							
for employee retirement	54	54	57	59	62	66	69
Medicare premiums	13	16	17	20	21	23	26
Deposit insurance premiums	7	6	6	7	7	8	4
Other	1	1	2	2	2	1	c
Geographic exclusions	-2	-2	-3	-3	-3	-3	-3
Other	-2	2	-3	-5	-1	-1	-5
Total	71	76	78	81	89	94	92
Receipts (NIPA basis)	1,162	1,227	1,322	1,413	1,491	1,565	1,638
			Expenditures				
Outlays (Budget basis)[b]	1,381	1,416	1,497	1,529	1,592	1,670	1,747
Differences							
Netting and grossing							
Government contributions							
for employee retirement	54	54	57	59	62	66	69
Medicare premiums	13	16	17	20	21	23	26
Deposit insurance premiums	7	6	6	7	7	8	4
Other	1	1	2	2	2	1	c
Lending and financial transactions							
Deposit insurance	-2	23	-17	5	5	2	1
Other	-19	-6	-4	c	7	3	4
Defense timing adjustment	2	4	1	1	1	1	1
Geographic exclusions	-8	-8	-9	-9	-10	-10	-11
Other	-1	-6	-9	-7	-4	-7	-8
Total	49	83	45	78	91	86	88
Expenditures (NIPA basis)	1,430	1,500	1,542	1,607	1,683	1,756	1,834
			Deficits				
Deficit (Budget basis)[b]	290	266	253	196	190	198	200
Differences							
Lending and financial transactions	-20	17	-21	5	12	6	5
Defense timing adjustment	2	4	1	1	1	1	1
Geographic exclusions	-5	-6	-6	-7	-7	-7	-8
Other	1	-8	-7	-2	-3	-6	-3
Total	-23	7	-33	-3	2	-7	-4
Deficit (NIPA basis)	268	273	220	194	192	191	196

SOURCE: Congressional Budget Office.

a. Department of Commerce, *Survey of Current Business* (April 1993).

b. Includes Social Security and the Postal Service.

c. Less than $500 million.

Table 2-9.
Projections of Baseline Receipts and Expenditures Measured by the National Income and Product Accounts (By fiscal year, in billions of dollars)

	Actual 1992[a]	1993	1994	1995	1996	1997	1998
			Receipts				
Personal Tax and Nontax Receipts	486	505	551	599	639	672	711
Corporate Profits Tax Accruals	111	127	136	142	149	156	162
Indirect Business Tax and Nontax Accruals	81	86	89	93	95	97	96
Contributions for Social Insurance	485	509	546	578	609	640	670
Total	1,162	1,227	1,322	1,413	1,491	1,565	1,638
			Expenditures				
Purchases of Goods and Services							
Defense	314	308	303	308	316	324	333
Nondefense	131	139	145	151	155	160	165
Subtotal	445	448	448	460	472	484	498
Transfer Payments							
Domestic	594	634	666	710	753	801	851
Foreign	10	14	14	15	15	15	16
Subtotal	603	648	680	724	768	816	866
Grants-in-Aid to State and Local Governments	169	186	202	216	230	246	265
Net Interest	188	185	190	202	215	225	235
Subsidies Less Current Surplus of Government Enterprises	25	34	32	30	30	31	33
Required Reductions in Discretionary Spending	n.a.	n.a.	-11	-25	-32	-47	-62
Total	1,430	1,500	1,542	1,607	1,683	1,756	1,834
			Deficit				
Deficit	268	273	220	194	192	191	196

SOURCE: Congressional Budget Office.

NOTE: n.a. = not applicable.

a. Department of Commerce, *Survey of Current Business* (April 1993).

Classifying government expenditures as to their purpose and destination is somewhat more problematic. Defense and nondefense purchases of goods and services clearly enter directly into gross domestic product. Other categories (chiefly transfers, grants, and interest) contain payments to individuals or state and local governments. Ultimately, these payments may enter GDP as consumption, as state or local purchases, or as yet another category of demand depending on how recipients use the funds. For example, Social Security payments (the biggest transfer program) may be used for a variety of purchases--from durable goods to services--and will not be counted as part of GDP until the funds are spent.

As discussed earlier in this chapter, the Budget Enforcement Act of 1990 and the Omnibus Budget Reconciliation Act of 1993 imposed caps on discretionary spending through 1998. These caps impose a virtual freeze on such outlays. The final expenditure entry in Table 2-9 depicts the unspecified savings needed to comply with the caps in 1994 and beyond, relative to a path that would permit such spending to keep pace with inflation. The savings cannot be assigned to particular NIPA categories but are most likely to come from defense and nondefense purchases and grants.